By Juan E. Gonzalez

A Robust Economy

The outlook is bright, although 1998 won't bring the explosive growth of the early '90s

SUMMARY

The 1998 regional economic outlook calls for expansion of auto-related, construction-related, and durables manufacturing. The apparel industry is expected to continue to decline, but it will do so at a slowing rate. Construction activity, although weakened, will be buoyed by high levels of in-migration. Tourism and the service sector are expected to maintain healthy growth rates. Government-sector expansion will remain restricted.

The recent performance of the [U.S.] economy, characterized by strong growth and low inflation, has been exceptional—better than most anticipated. . . . The economy is now in the seventh consecutive year of expansion, making it the third longest post-World War II cyclical upswing to date.

—Alan Greenspan,
Federal Reserve chairman

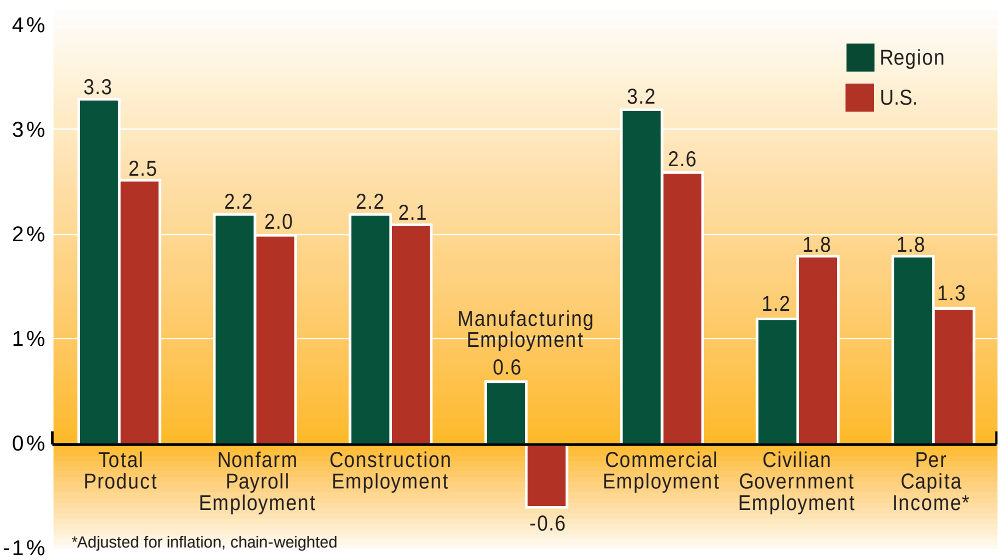
The Valley's share of the growth that Alan Greenspan described to Congress on July 22 has been a generous one. Between the end of the 1991 recession and today, total gross regional product (GRP) rose by an annual average rate of 4.1 percent, compared with the nation's 2.8 percent annual growth in gross domestic product (GDP). Indications are that the expansion will continue.

The Valley's 1998 GRP is expected to grow at a rate of 3.3 percent; the current consensus is that the nation's GDP will expand at 2.5 percent (*see chart, below left*). The regional figure represents only a slight slowdown from this year's strong performance—the Valley is expected to wind up at about 3.5 percent for 1997, roughly the same as the national rate—as manufacturing improves into 1998.

Nondurable-goods manufacturing remains an area of weakness, but durable goods (those that last three or more years, like cars and appliances) are growing. That momentum is expected to carry into 1998, making up for the weakness in nondurables. Construction should remain healthy, but it will slow from the very rapid growth of the past few years. The current good growth in services will continue, helped by high rates of migration and rising tourism.

Although this forecast calls for a strong regional performance next year, the predicted growth pales in comparison with that experienced from the end of the 1991 recession through 1994: the latest revised data for national and regional total gross product show that the area's economy grew at about twice the U.S. rate during the period (*see chart, opposite*). In 1995 that speedy growth decelerated

VALLEY VERSUS U.S.: PREDICTED CHANGE IN GRP, INCOME, AND SECTOR EMPLOYMENT, 1998



Gross regional product in the Tennessee Valley should grow by about 3.3 percent in 1998.

to about the national rate. This pattern is expected to continue through 1997.

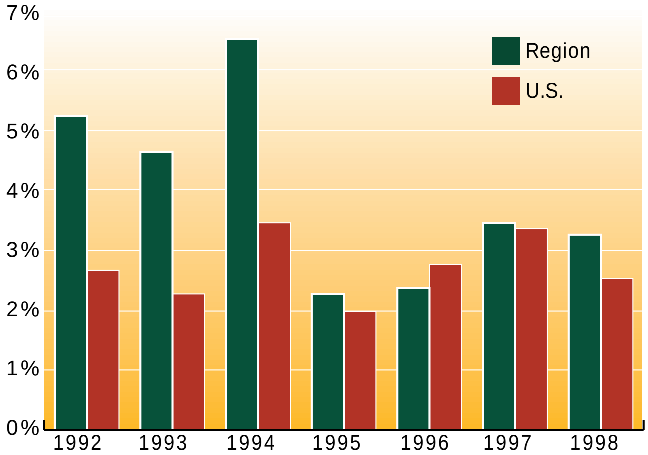
There are many similarities between the current state of the region's economy and the conditions that prevailed in 1992, but important differences account for the more muted growth projected for 1998.

First, there are dissimilarities in the business cycle. In 1992 the U.S. economy was emerging from the 1991 recession, which had been caused by rising oil prices following the Iraqi invasion of Kuwait and rising interest rates resulting from the Federal Reserve's efforts to ease inflationary pressures. As income rose and the Fed supported growth through lower interest rates, there were strong increases in the demand for manufactured goods. Between 1992 and 1994, people bought the houses, cars, appliances, and other big-ticket items that had been put off during the recession. Since the Valley's economy is heavily geared to manufacturing, the U.S. economic expansion made the area's economy grow even faster.

In 1997, by comparison, the nation is emerging from a Fed-engineered economic slowdown, not a recession. Interest-rate changes always have a disproportionate effect on construction and manufacturing, both important elements of the Valley economy. As the region felt the effects of Fed rate increases in 1995, its growth rate decelerated more than the nation's. Now that the U.S. economy has strengthened once more, the region has followed suit, and manufacturing growth leads the way as it did in 1992.

However, the current upturn has proceeded at a much more moderate pace, in part because the nation suffered only a slowdown. Consumption was not as subdued as in a recession, and thus the subsequent pickup in demand for housing, cars, and other consumer durables has been less pronounced. Evidence of the economy's rebound is nevertheless real, as shown by improvement in such construction-related manufacturing as carpet-making and in durable-goods output over 1996 levels.

REGIONAL AND NATIONAL GROSS PRODUCT GROWTH



The Valley economy's growth at the end of the decade will be solid, but it won't sizzle quite as much as it did in the early '90s.

Another difference between '92 and '97 is that the region's economy does not look as strong in comparison with the nation's this time around, because other regions of the country are in much better shape than they were in the early '90s. At that time the Northeast was still very weak and California was essentially in a recession; now these areas are growing. Indeed, the consensus prediction of national economic conditions for 1997, given in last year's *Economic Edge* forecast, was revised sharply upward as other regions experienced far stronger growth than expected. Our own 1997 Valley forecast was also revised upward as a result of this stronger national growth, but was considerably closer to the current picture for the year.

The business-cycle-related pattern of manufacturing growth described above explains only part of the difference between economic conditions in the early '90s and today. An equally important factor is the

PROFILE OF THE TVA POWER SERVICE AREA

TVA's power service area consists of 170 counties in Tennessee and parts of six surrounding states.

In 1996 the Valley's economy totaled about $196 billion in gross product, $159 billion in personal income, 3.7 million in nonfarm payroll employment, and 7.9 million in population—roughly 3 percent of the U.S. totals.

Some 44 percent of the region's population lives in nonmetropolitan areas, compared with 22 percent of the nation's. And in 1996 manufacturing employment made up 24 percent of the Valley's nonfarm payroll employment; the national figure was 15 percent.

growth engine of the region's thriving auto-related industry. Since 1980 motor-vehicle-related production has aggregated along the I-65 and I-75 corridors, and the Valley is at the center of the industry's southern concentration. The Japanese in particular have developed a significant presence here, with both assembly and supplier production facilities. Each segment is healthy. During the early '90s, however, other circumstances boosted their rapid growth to boomlike proportions. In 1993 the Nissan plant near Nashville expanded with the addition of the new Altima model. Also, as the dollar decreased in value against the yen, it became increasingly cost-effective for U.S.-manufactured Japanese-nameplate vehicles to use parts made in America. But the strongest auto-related economic effect on the Valley still stems from the opening of the Saturn plant near Nashville. In the four years following its start-up in 1990, the Saturn plant alone brought nearly 8,000 jobs to the region; many of its suppliers also relocated to or expanded in the Valley. All this has added greatly to the region's economic growth.

WHY MANUFACTURERS LIKE THE VALLEY

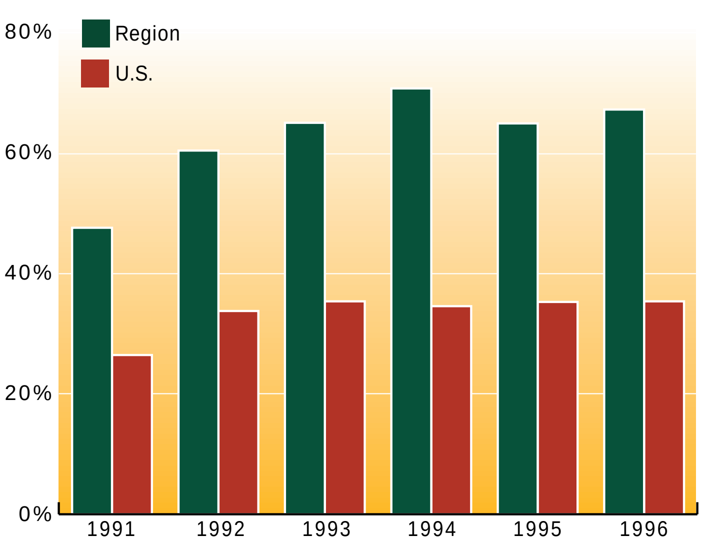
Location. The region is convenient to most major U.S. markets.

Transportation. Goods can be shipped by interstate, rail, air, or barge.

Low-wage workforce. Average regional earnings in manufacturing are about 21 percent below the national average.

Low-cost, abundant resources. Water, land, and electricity are plentiful, and TVA's low rates have helped keep industrial production costs down.

MIGRATION AS A PERCENTAGE OF POPULATION INCREASE



Steady in-migration continues to swell the Valley's workforce.

Of course, none of that growth would be possible if it weren't for the availability of a suitable workforce, and here again the area has been fortunate. As our economy persisted in outperforming other regions of the country during the first part of the decade, migration into the Valley made up an increasing proportion of overall population growth (*see chart, below*). By 1994 over 70 percent of the region's growth in population (more than twice the U.S. average) came from the migration of workers flooding into the region to take the new jobs generated by the growing manufacturing sector.

A recent Conference Board study shows, moreover, that about a third of the net migration into the Valley from other parts of the U.S. between 1990 and 1994 consisted of people from the East North Central area (Illinois, Indiana, Michigan, Ohio, and Wisconsin)—a region known for the manufacturing expertise of its labor force, particularly in auto-related occupations.

This combination of fast manufacturing growth and migration had a spillover effect on other parts of the economy. It generated additional service jobs as businesses made purchases and workers spent their paychecks locally. Warehousing and distribution centers expanded. Health care, telemarketing-related services, and tourism also saw notable increases. The fast-growing population and intensified business activity made construction strong during this period. Even as manufacturing decelerated in 1995, services and construction carried the region's economy through 1996.

This year regional durables manufacturing has again been expanding as companies seek the advantages inherent in the Valley's location (*see sidebar, above left*). The production outlook index from the Atlanta Federal Reserve's regional manufacturing survey is at levels not seen since before 1995. The state of Tennessee reports that the number of announced new jobs and investments occurring within its borders in the first half of this year reached the highest level since early 1992. This bodes very well for the regional economy in 1998, as does the outlook for the national economy.

The current national economic momentum, sustained by strong consumer confidence and business investment, is expected to last into 1998. Recent federal tax-cut legislation should further stimulate growth. Energy prices are likely to remain low, and the shrinking federal budget deficit will continue to put downward pressure on interest rates, even as it restricts government growth. Worldwide capacity remains ample as investment continues and slow growth in Europe and Japan holds down demand.

On the other hand, U.S. labor markets remain tight, and inflationary pressures (including labor demands, as evidenced by the UPS strike earlier this year) have been growing. This should eventually lead the Fed to tighten monetary policy, thus producing higher interest rates in the financial markets. Curtailed economic growth will result, but as in 1994, it will occur after a delay and not before late next year at the earliest.

In view of this positive national outlook, regional manufacturing should continue its expansion into 1998. But the explosive growth that characterized the early 1990s will not recur, because the additional factors that sparked it are no longer in place.

The auto-related sector continues to expand in the Valley, especially as car sales pick up and assembly investments outside the region, such as the new Mercedes-Benz plant in Alabama, provide a boost to the region's auto-parts industry. Nevertheless, there are no Saturn-style investments in the offing, and neither Nissan nor Saturn is expected to make any significant expansions. Saturn is suffering from heavy competition. The new Nissan plant in Decherd, Tennessee, began supplying engines for its expanded Altima production in May, and it is expected to begin production of a sport utility vehicle in 1999. But Nissan is also shifting Sentra production to Mexico.

Meanwhile, the lower value of the yen and the weakness of the Japanese economy will continue to slow both regional exports and the further replacement of imported parts with Valley-made parts for Japanese-nameplate vehicles. Thus, while the auto-related industry will thrive, it won't achieve the unusually vigorous growth of the early '90s.

Another circumstance that will preclude growth similar to that of 1992 is the decline of the regional apparel industry since 1994. Many plants have closed since then, as international competition—heated by the collapse of the Mexican peso just as NAFTA lowered trade barriers with Mexico—became intense. The region is still losing apparel jobs, but the rate has declined to single digits from last year's double digits. These losses will continue to be a drag on regional growth in 1998.

Migration into the Valley, although it has slowed since 1994, will remain high, enlarging the region's labor force and increasing demand for goods and services such as housing. While regional construction activity remained quite robust through 1996, this was mostly due to a catch-up effect from the strong growth experienced earlier. Once inventories were built up, activity slowed, and the slower pace is expected to last into 1998.

Overall, these factors will lead to strong regional growth in 1998, but the rate will be considerably more moderate than the explosive performance of the early 1990s. □

DAVID LUTTRELL

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Gonzalez is the author of several papers on regional economics and has been quoted in many publications, including *The Wall Street Journal*. He is a graduate of the University of Miami and the University of Florida.

Growth Rates for the Valley's Economic Subregions, 1998

Although the Tennessee Valley's economic subregions are interlinked and share many of the same comparative advantages for manufacturing and other economic endeavors, they have distinct differences that account for the variations in their respective economic growth trends. Note that western Kentucky is included with West Tennessee and south central Kentucky with Nashville.

TVA POWER-SERVICE AREA	
Employment	
Nonfarm	2.2%
Construction	2.2%
Manufacturing	0.6%
Durables	1.1%
Nondurables	0.1%
Service sector	3.2%
Civilian government	1.2%
Personal income*	3.0%
Population	1.18%
Personal income per capita*	1.8%

ALABAMA	
Employment	
Nonfarm	2.0%
Construction	2.4%
Manufacturing	0.9%
Durables	1.0%
Nondurables	0.7%
Service sector	3.0%
Civilian government	1.1%
Personal income*	2.8%
Population	0.96%
Personal income per capita*	1.8%

CHATTANOOGA	
Employment	
Nonfarm	2.2%
Construction	2.0%
Manufacturing	1.1%
Durables	0.4%
Nondurables	1.4%
Service sector	3.2%
Civilian government	1.0%
Personal Income*	2.9%
Population	1.20%
Personal income per capita*	1.7%

KNOXVILLE	
Employment	
Nonfarm	2.2%
Construction	2.0%
Manufacturing	0.1%
Durables	1.5%
Nondurables	-1.5%
Service sector	3.3%
Civilian government	0.9%
Personal income*	2.9%
Population	1.22%
Personal income per capita*	1.7%

MISSISSIPPI	
Employment	
Nonfarm	2.0%
Construction	3.4%
Manufacturing	0.7%
Durables	1.7%
Nondurables	-0.9%
Service sector	3.3%
Civilian government	1.1%
Personal income*	2.8%
Population	0.87%
Personal income per capita*	1.9%

NASHVILLE	
Employment	
Nonfarm	2.4%
Construction	1.9%
Manufacturing	0.5%
Durables	1.2%
Nondurables	-0.7%
Service sector	3.4%
Civilian government	1.6%
Personal income*	3.3%
Population	1.61%
Personal income per capita*	1.6%

TRI-CITIES	
Employment	
Nonfarm	2.1%
Construction	2.5%
Manufacturing	0.8%
Durables	0.5%
Nondurables	1.1%
Service sector	3.1%
Civilian government	1.1%
Personal income*	2.8%
Population	0.92%
Personal income per capita*	1.9%

WESTERN	
Employment	
Nonfarm	2.2%
Construction	2.0%
Manufacturing	0.4%
Durables	0.9%
Nondurables	0.0%
Service sector	3.0%
Civilian government	1.2%
Personal income*	2.9%
Population	0.89%
Personal income per capita*	2.0%

*Personal income, both total and per capita, is in constant dollars adjusted to account for inflation (1992 chain-weighted dollars).